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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

COUNTY OF SAN DIEGO, CALIFORNIA; GREGORY J. SMITH, SAN DIEGO COUNTY ASSESSOR; and PAUL BOLAND, SAN DIEGO COUNTY TAX COLLECTOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. Respondents err in contending that the decision in this case is an ordinary application of the settled principle that a State may tax the "private beneficial use of federal property" (Br. in Opp. 7). As this Court has explained, the "vital thing" in determining whether a taxable "beneficial use" exists is whether the federal contractor is "using the property in connection with its own commercial activities" (*United States* v. *Township of Muskegon*, 355 U.S. 484, 486 (1958)) or is, instead, using the property "*only* in performing [its] job" (*United States* v. *County of Fresno*, 429 U.S. 452, 466 n.15 (1977)). When the contractor "is merely performing its contractual obligations on government

owned property," it cannot be said that the contractor has a "private beneficial use" of the property. *United States* v. *Colorado*, 627 F.2d 217, 220 (10th Cir. 1980), aff'd, 450 U.S. 901 (1981). See Pet. 15-16.

In the present case, the contractor constructed, managed and operated property for the government but was not permitted any independent, commercial use of that property (Pet. App. 28a; Pet. 4). The income that the contractor received from its federal contract work is taxable by the States; but the federal property that the contractor managed is not. *United States* v. *Colorado*, 627 F.2d at 220. The annual *ad valorem* tax on the value of the federal property that the contractor managed was unconstitutionally imposed "on property owned by the United States." *Id.* at 221.

The court of appeals recognized that the federal contractor in this case was *not* permitted to use the government's property in independent commercial activities. The court of appeals nonetheless reasoned that the contractor could be taxed for the value of that property because of the "valuable knowledge" and "expertise" that the contractor obtained from its work for the government (Pet. App. 18a, 20a, 22a). For the reasons explained at length in the petition—which respondent does not address or rebut—that analysis is a marked departure from precedent and conflicts with the decisions of this Court and other courts of appeals. See Pet. 16-20.

2. a. In contending that the State's annual *ad valorem* tax is properly apportioned to the contractor's "beneficial personal use" of the government's property, respondents incorrectly describe certain relevant facts. First, respondents suggest that the state tax is properly imposed on the value of the federal property because the federal contractor re-

ceived several hundred million dollars "under the contracts covering the use of the device" (Br. in Opp. 8). The contracts did *not*, as respondents' statement suggests, involve "use of the device" by the federal contractor. Instead, the contracts involved the construction, maintenance and operation of the device by the contractor under the specific direction and control of the federal government (Pet. App. 28a). No revenues were obtained by the contractor from any independent "use" of the device.

The revenues referred to by respondents consisted entirely of reimbursement for the costs of construction and operation of the federal property and the contractor's annual service fee (Pet. App. 12a-13a). These revenues *are* subject to state tax. What the State may not tax, but is attempting to tax in this case, is the property of the United States itself.

Respondents go on to state that the federal contractor received significant additional revenues from fusion research, and they imply that these revenues were the result of the knowledge and expertise developed from the contractor's work with the Doublet device. See Br. in Opp. 8. The affidavit on which respondents rely, however, states specifically that these other sources of revenue were *not* obtained from use of the Doublet device and also were *not* obtained from application of the "knowledge" or "expertise" the contractor acquired in performing the government contract. The affidavit explains that virtually all of the contractor's commercial revenues were derived from private and government contracts that did *not* relate to the Doublet device and that "only $176,000 [of its commercial revenues] involved Doublet-derived technology" (CR 38, Overskie Decl. at 3).

The tax that respondents assessed bears no relationship to the value of the incidental "beneficial personal use" described by the court of appeals. The tax exceeds by several times the total economic benefits ($176,000) that the contractor assertedly derived from the "knowledge" and "expertise" resulting from its management and operation of the government's property. Because the tax assessed by respondents does not meaningfully "sever" or "segregate" the value of the alleged "beneficial personal use" from the value of the property itself, the tax unconstitutionally falls on property values belonging solely to the United States. See, *e.g.*, *United States* v. *County of Allegheny*, 322 U.S. 174, 187 (1944); *United States* v. *Hawkins County*, 859 F.2d 20, 23 (6th Cir. 1988).

b. Respondents do not dispute that the decision in this case conflicts with *County of Allegheny* and *Hawkins County*. Indeed, although we relied on those decisions in the petition (Pet. 22-23 & n.14), respondents' brief simply ignores them.

Respondents contend (Br. in Opp. 11-12) that the decision in this case is consistent with this Court's decision in *United States* v. *City of Detroit*, 355 U.S. 466, 470 (1958). That contention is incorrect for the reasons we explain in the petition (Pet. 21-22). When, as in *City of Detroit*, the contractor is given free and unrestricted commercial use of federal property in conducting a manufacturing business, a tax on the full value of the property is sustainable. *Ibid.* That decision does not support, however, a suggestion that the States may impose a tax on the value of federal property that is placed in the hands of a contractor who is *not* allowed to use the property in independent, commercial endeavors. Instead, as this Court has

held on several occasions, when the contractor's "use" of the property is limited, the value assigned to that "use" must be "severed from" the value of the property belonging to the government (*United States* v. *County of Fresno*, 429 U.S. 452, 466 (1977)). Moreover, in this case, the contractor had no right at all to use the fusion device in any commercial activity; it had only the duty to manage the use of the device for the government. See Pet. 4.

3. The expansive rationale adopted by the court of appeals would make essentially all property of the United States that is placed in the custody of federal contractors or employees subject to annual state *ad valorem* taxes. There is no logical basis for distinguishing the "valuable knowledge" and "expertise" gained by the manager of the government's experimental fusion device from the "valuable knowledge" and "expertise" gained by a federal contractor or employee who has custody or possession of other types of government property. See Pet. 23 & n.15.

As the petition notes (Pet. 24), the value of federal property that would be subject to annual state property taxes under the reasoning of the decision in this case is enormous. Respondents contend, however, that the burden of such taxes must be unimportant because the United States "voluntarily assumed the tax burden" by agreeing to reimburse federal contractors for valid state taxes (Br. in Opp. 14). That contention is based on a flawed economic analysis.

The United States has no option, other than litigation, to avoid the burden of unconstitutional state taxes imposed on its contractors. If the United States declined to reimburse federal contractors for such taxes, the economic burden of the taxes would still flow to the United States. When state property

taxes are imposed on federal property in the hands of a contractor, the contractor will either demand reimbursement or raise its contract price to cover the additional costs that the taxes represent. Taxes imposed on contractors—like other types of unavoidable costs—eventually flow to the consumer of the service being taxed, either directly (through reimbursement) or indirectly (through higher contract prices). See *Boyle* v. *United Technologies Corp.*, 487 U.S. 500, 511-512 (1988). A contractor will not perform a service for which it cannot obtain a payment that encompasses all of its costs (plus a profit). The burden of unconstitutional taxes on federal property thus falls ultimately on the United States as a matter of economic reality, not from any "voluntary" assumption of that burden by the United States.

Because the decision in this case conflicts with decisions of this Court and of other courts of appeals, and because the rationale employed by the court of appeals would materially erode the constitutional immunity of the United States from taxation by the States, further review by this Court is warranted. See Pet. 14-24.

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For the reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Solicitor General

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